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No. 96-1627

In the Supreme Court of the United States

OCTOBER TERM, 1996

THEODORE VAN ZELST, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

WALTER DELLINGER
Acting Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
RICHARD FARBER
ROBERT W. METZLER
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

13 pp

QUESTION PRESENTED

Whether additions to tax for underpayments of tax resulting from negligence (26 U.S.C. 6653(a) (1986)) and from valuation overstatement (26 U.S.C. 6659 (1986)) were correctly imposed against petitioners.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 100 F.3d 1259. The opinion of the Tax Court (Pet. App. 18a-58a) is reported at 70 T.C.M. (CCH) 435.

JURISDICTION

The judgment of the court of appeals was entered on November 15, 1996. The petition for rehearing was denied on January 15, 1997 (Pet. App. 17a). The petition for a writ of certiorari was filed on April 14, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On their federal income tax returns for 1985, 1986, and 1987, petitioners claimed charitable contribution deductions for their donation to the National Park Service of interests in real property located in a remote part of Alaska, approximately 230 miles northeast of Anchorage (Pet. App. 18a-22a, 25a). The donated property consists of 93 "patented" acres, in which petitioners had a fee simple interest, and 154 "unpatented" acres, in which petitioners held only subsurface or mineral rights. The patented acres are located on very steep terrain on the north side of a mountain that limits their exposure to sunlight. Access to the location of these tracts is available by helicopter or small plane. Such access is inhibited, however, by Glacier Creek, which has no bridge and which separates the patented acres from the nearest airstrip (*id.* at 25a-26a, 41a).

Petitioners acquired this property in 1983 for approximately $30,000 (Pet. App. 5a). Before that date, four separate companies had attempted to mine the property over a period of 43 years. All had concluded, however, that it was not feasible to do so (*id.* at 47a). On their tax returns, petitioners nonethelesss claimed that the donated property had a value of $2.75 million, and they asserted a charitable deduction for that amount. On audit of those returns, the Commissioner determined that petitioners had grossly overstated the actual fair market value of the property on the date that it was donated (*id.* at 18a-22a, 30a, 57a). The Commissioner therefore disallowed all but a small amount of the claimed charitable deduction and further concluded that petitioners were liable for additions to tax for negligence under 26 U.S.C.

6653(a) (Supp. IV 1986) and for valuation overstatement under 26 U.S.C. 6659 (Supp. IV 1986) (Pet. App. 53a, 55a).[1]

2. Petitioners sought review of the Commissioner's determinations in the Tax Court. Petitioners sought to justify their $2.75 million valuation based upon testimony concerning the potential value of the property as a resort and as a copper mine. The Tax Court found, however, that the fair market value of the property on July 30, 1985, the date of its donation, was only $38,000 (Pet. App. 30a-31a, 53a). In reaching that conclusion, the court relied on the testimony of (i) experts in real estate development who concluded that the property had no value as a potential resort and had a value of only $28,000 as undeveloped real estate and (ii) experts in mineral extraction who concluded that the property had only a minimal, speculative value as a mine (*id.* at 38a-51a).

The Tax Court also concluded that petitioners were liable for the addition to tax for negligence (Pet. App. 54a-57a). The Tax Court stated that "[m]ere reliance on an appraiser or expert in a matter does not automatically shield a taxpayer from the negligence addition; a taxpayer must affirmatively establish that his reliance was reasonable, prudent, and in good faith" (*id.* at 55a). In rejecting petitioners' claim that they relied in good faith on an appraisal, the court noted that only two of the petitioners had testified, that the two who testified were sophisticated investors, and

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[1] After the years in suit, the provisions of the Internal Revenue Code imposing the additions to tax for negligence and for valuation overstatement were revised. Those additions to tax are currently imposed under 26 U.S.C. 6662. See Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7721, 103 Stat. 2106.

that facts known to these petitioners put them on notice that the expert appraisal they obtained to support their claimed deductions greatly overstated the value of the property (*id.* at 55a-56a).[2] The court also noted that "common sense should have come into play for all petitioners [since] [i]t was unreasonable for petitioners to expect that property purchased for $30,174 would increase to a value of $2,750,000 just 2 years later" (*id.* at 56a).

The court further found that the Commissioner had properly imposed the addition to tax for valuation overstatements under Section 6659 (Pet. App. 57a-58a). The court noted that "petitioners attempted to claim a charitable contribution deduction for approximately 91 times the amount T.W. Van Zelst paid for the property 2 years prior to donation" (*id.* at 57a), that petitioners did not have a reasonable basis for the value they claimed on their returns, and that their claimed deduction was therefore not made in good faith (*id.* at 58a).

3. The court of appeals affirmed (Pet. App. 1a-16a). The court held that the Tax Court's finding that the subject property had a fair market value of $38,000 on the donation date was not clearly erroneous (*id.* at 8a):

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[2] These facts included (i) the absence of any event that would have substantially increased the value of the property between the date petitioners acquired it for approximately $30,000 and the date of its donation to the Park Service; (ii) the decline in copper prices during that same period; (iii) the unrealistic nature of the "hypothetical resort" analysis used in the appraisal prepared for petitioners; and (iv) the economic infeasibility of mining on the property at the time of the donation (Pet. App. 56a).

> Evidence was presented on both sides; the trier of fact was entitled to choose.

The court emphasized that such disputed questions of fact are "for the Tax Court to resolve" (*ibid.*). The court added, however, that "[o]ur own view, to the extent it matters, is that the trial judge was on the mark" (*ibid.*).

The court of appeals further concluded that the Tax Court correctly upheld the additions to tax imposed for negligence and gross overvaluation (Pet. App. 11a-16a). The court rejected petitioners' claim that they had reasonably relied on an expert appraisal because "the appraisal is nonsense on its own terms" (*id.* at 8a). The court noted that $2.10 million of the $2.75 million value attributed to the property by petitioners' expert was associated with its proposed use as a resort (*id.* at 15a-16a). The court emphasized that the remoteness of the property (along with numerous other factors) made it highly unlikely that a profitable resort could be constructed on the property (*id.* at 7a-10a, 16a). The court succinctly concluded that the entire record demonstrated that petitioners "had to have known that [their valuation] estimate was hooey, the sort of number ginned up to put one over on the revenooers" (*id.* at 15a).

The court of appeals also found unpersuasive petitioners' assertion that the Alaska Regional Director of National Parks had advised them that their expert "is the best you can get" (Pet. App. 15a). The court explained that "The Park Service wants to encourage donations, and sky-high appraisals do so" (*ibid.*). The court pointed out, however, that "[t]he Park Service cannot bind the Revenue Service" (*ibid.*). Moreover, the expert that the Park Service had recommended

had not prepared the resort valuation figures, and "[i]t was the ludicrous attribution of $2.1 million to this [property as a potential resort] that propelled the parcel's total valuation into the stratosphere. The Tax Court did not exceed the scope of the reasonable in its evaluation of these events." *Id.* at 16a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Petitioners contend that they should not be subject to the additions to tax for negligence and valuation overstatement. They assert that such additions to tax are improper because they relied on an appraisal report prepared by an expert in claiming their grossly inflated charitable contribution deductions. The courts below properly concluded, however, that petitioners' reliance on the appraisal report prepared by their expert was not reasonable in the circumstances (Pet. App. 14a-15a, 55a-56a). Further review of this factual determination, concurred in by both courts below, is not warranted. See *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985).

As the court of appeals emphasized, the resort property appraisal on which petitioners purport to have relied was "nonsense on its own terms" (Pet. App. 8a). Moreover, the tremendous gap between the $30,000 price paid for the property by petitioner Van Zelst in 1983 and the $2.75 million value assigned to the property in the appraisal report for 1985 would have put a reasonably prudent person on notice that something was amiss. Since petitioners had detailed knowledge

about the substantial problems that made extraction of minerals from the property economically infeasible —and which also precluded other types of commercial exploitation—the court of appeals properly concluded that their purported reliance on the appraisal report was entirely unjustified. The record amply supports the court's emphatic conclusion that the expert appraisal was obviously "hooey, the sort of number ginned up to put one over on the revenooers" (*id.* at 15a).

2. Petitioners err in contending (Pet. 12-15) that the decision in this case conflicts with decisions of other circuits (Pet. 12-15, citing *McMurray* v. *Commissioner*, 985 F.2d 36 (1st Cir. 1993); *Chamberlain* v. *Commissioner*, 66 F.3d 729 (5th Cir. 1995); *Mauerman* v. *Commissioner*, 22 F.3d 1001 (10th Cir. 1994); *Sammons* v. *Commissioner*, 838 F.2d 330 (9th Cir. 1988)). As the courts below noted (Pet. App. 14a, 55a), and as the cases cited by petitioners demonstrate, reliance on professional opinion can create a defense to the imposition of additions to tax for negligence and valuation overstatement only if that reliance is objectively reasonable and in good faith. *Chamberlain* v. *Commissioner*, 66 F.3d at 732. As the court of appeals stated in this case, "[a]n appraisal may show that the taxpayer acted both prudently and reasonably, but it does not compel this inference" (Pet. App. 14a). None of the cases cited by petitioners is inconsistent with the principle that "a taxpayer must affirmatively establish that his reliance was reasonable, prudent, and in good faith" (*id.* at 55a). To the contrary, it is well established that reliance on professional opinion is not a defense to additions to tax when such reliance is not reasonable. See *Sacks* v. *Commissioner*, 82 F.3d 918, 920-921 (9th Cir. 1996);

Chakales v. *Commissioner*, 79 F.3d 726, 729 (8th Cir.), cert. denied, 117 S. Ct. 85 (1996); *Westbrook* v. *Commissioner*, 68 F.3d 868, 880-881 (5th Cir. 1995); *Goldman* v. *Commissioner*, 39 F.3d 402, 408 (2d Cir. 1994); *Illes* v. *Commissioner*, 982 F.2d 163, 167 (6th Cir. 1992), cert. denied, 507 U.S. 984 1579 (1993); *Accardo* v. *Commissioner*, 942 F.2d 444, 452-453 (7th Cir. 1991), cert. denied, 503 U.S. 907 (1992). The factual determination of the courts below that the purported reliance of petitioners on the facially implausible report of their appraisers was not reasonable and was not in good faith is amply supported by the record. That factual determination does not warrant further review.

3. Petitioners contend that this Court should review the decision below because the court of appeals denigrated the reputation of the National Park Service (Pet. 18-19). Petitioners, of course, do not represent the Park Service. Moreover, it is plain that petitioners, perhaps for their own purposes, have exaggerated the purported insult. Compare Pet. 19 with Pet. App. 15a-16a. The observation of the court of appeals that the Park Service wanted to encourage donations of property, and that "sky-high" appraisals would do so (*id.* at 15a), was made in the context of pointing out that the interests of the Park Service and the Internal Revenue Service were divergent. That observation, which did no more than state the obvious, clearly does not warrant review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

WALTER DELLINGER
Acting Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
RICHARD FARBER
ROBERT W. METZLER
Attorneys

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